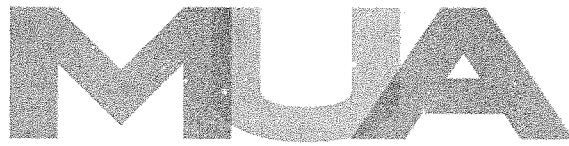


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**UNDERGRADUATE UNIVERSITY EXAMINATIONS**

**SCHOOL OF MANAGEMENT AND LEADERSHIP**

**DEGREE OF BACHELOR OF COMMERCE**

**BCM 221 : ACCOUNTING FOR LIABILITIES**

**DATE: 14TH DECEMBER 2016**

**DURATION: 2 HOURS**

**MAXIMUM MARKS: 70**

**INSTRUCTIONS:**

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. Write all your answers in the Examination answer booklet provided.

### QUESTION ONE

Read the Case Study below carefully and answer the questions that follow:

#### HISA COMPANY LIMITED

Hisa Company Ltd. was incorporated in 1988 with an issued share capital of 2,500,000 ordinary shares of Sh.10 each and 1,000,000 8% cumulative participating preference shares of Sh.10 each. All the shares were paid for in full.

In 1992, the company issued 2,500 10% debentures of Sh.1000 each. The terms of issue stipulate that each debenture is convertible into 75 ordinary shares of Sh.10 each on 31 December 2003 and those not converted will be redeemed at par on 31 December 2008.

On 1 March 1998, the company granted its directors options to take up 500,000 ordinary shares at a price of Sh.12 per share.

On 1 April 1999, the ordinary shares were split into shares of Sh.2.50 each and on 1 December 1999 a further 3,000,000 ordinary shares were issued at fair value to satisfy the purchase of certain business rights acquired.

On 2 December 1999, 200,000 of the above options were taken up when the fair value of the shares was Sh.6 each. The average fair value of the shares during the year was, Sh.5 each. The following information has been extracted from the consolidated income statements for the years ended 31 March 1999 and 31 March 2000.

	2000 Sh. '000'	1999 Sh. '000'
Net operating income	19,800	18,410
Income from investments	<u>420</u>	<u>360</u>
Net income before taxation and extraordinary items	20,220	18,770
Taxation	<u>(7,630)</u>	<u>(6,920)</u>
Net income after taxation	12,590	11,850
Less: Minority interest	<u>(1,270)</u>	<u>(1,440)</u>
Profit attributable to members of the group	11,320	10,410
Extraordinary items	<u>(2,000)</u>	<u>(1,500)</u>
Profit after tax and extraordinary items	9,320	8,910
Dividends (Note 1)	<u>(4,000)</u>	<u>(3,200)</u>
Retained profits for the year	5,320	5,710
Retained profit brought forward	<u>18,530</u>	<u>12,820</u>
Retained profit carried forward	23,850	18,530

**Note**

Dividends paid 31 March:

On ordinary shares	3,200	2,400
On preference shares	<u>800</u>	<u>800</u>
	<u>4,000</u>	<u>3,200</u>

**Required:**

- (a) Calculate the basic earnings per share figure to be disclosed in the published accounts of Hisa Company Ltd. for the years ended 31 March 1999 and 31 March 2000. (12 marks)
- (b) Calculate the diluted earnings per share figure to be disclosed in the published accounts of Hisa Company Ltd. for the year ended 31 March 2000. Assume a tax rate of 32.5% (10 marks)
- (c) Discuss the usefulness of the earnings per share figure. (3 marks)

**QUESTION TWO**

IAS 12 (revised) "Income Taxes" requires an enterprise to provide for deferred tax in full for all deferred tax liabilities with only limited exceptions. The original IAS 12

and the equivalent Kenyan Accounting Standard, allowed an enterprise not to recognize deferred tax assets and liabilities where there was reasonable evidence that timing differences would not reverse for some considerable period ahead; this was known as the partial provision method.

The original IAS 12 did not refer explicitly to fair value adjustments made on a business combination and did not require an enterprise to recognize a deferred tax liability in respect of asset revaluations. The revised IAS 12 now requires deferred tax adjustments for these items and classifies them as temporary differences.

**Required:**

- i. Explain why the IASC decided to require recognition of the deferred tax liability for all temporary differences (with certain exceptions) rather than allowing the partial provision method. (8 marks)
- ii. Discuss the reasons why IAS 12 (revised) requires enterprises to provide for deferred taxation on revaluations of assets and fair value adjustments on business combination. (7 marks)

### QUESTION THREE

K Limited has the following balance sheet and tax bases at 30 June 2000, before providing for any deferred tax in the year to 30 June 2000.

	Carrying values		Tax bases	
	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'
<b>Non-current assets</b>				
Buildings (Factory)		100,500		22,500
Plant and equipment		156,000		39,000
Investment in M Ltd.: cost		1,977		1,977
Long-term quoted investments		<u>198,000</u>		198,000
		456,477		
<b>Current Assets</b>	<u>45,000</u>		45,000	
<b>Current liabilities.</b>				
Trade payables	(40,500)		(40,500)	
Provision for repairs	<u>(900)</u>		(Nil)	
	<u>(41,400)</u>	<u>3,600</u>		
		460,077		
<b>Capital and reserves.</b>				
Equity capital		30,000		30,000
Revaluation reserve		73,500		-
Retained profit		<u>298,047</u>		-
Shareholders' funds		401,547		
<b>Non-current liabilities</b>				
Long-term loan	30,000		33,000	
Deferred tax (bal. b/i)	<u>27,030</u>		27,030	
		57,030		
<b>Deferred income:</b>				
Grant from World Bank		<u>1,500</u>		
		460,077		

1. K Limited acquired 100% of the ordinary share capital of M limited on 30 June 2000. The net assets of M limited as on this day were as follows:

	Fair value	Carrying value	Tax value
	Sh. '000'	Sh. '000'	Sh. '000'
Buildings (Factory)	1,500	900	300
Plant and equipment	120	90	45
Inventory	372	342	342
Trade receivables	330	330	330
Current liabilities	<u>(495)</u>	<u>(495)</u>	<u>(315)</u>
	<u>1,827</u>	<u>1,167</u>	<u>702</u>

M limited does not carry a deferred tax liability in its accounts.

2. K Limited's director decided to revalue K Limited's buildings at Sh.150 million and the plant and equipment to Sh.180 million, investments were not to be revalued. K Limited's buildings had cost Sh.135 million and the plant and machinery Sh.210 million.
3. The tax rate had changed from 35% to 30% in the current year.
4. During the year, the directors agreed to provide Sh.900,000 for future repairs to the buildings. The expense is allowable for tax when it is paid.
5. The grant from the World Bank is included as deferred income in the balance sheet and is not taxable.
6. Goodwill arising on acquisition is not an allowable expense for tax purposes. Since the subsidiary was acquired on 30 June 2000, no amortisation has been charged in the financial statements.
7. K Limited raised a long-term loan of Sh.33,000,000 during the year and recorded it net of transaction costs. The transaction costs of Sh.3,000,000 are allowable for tax in the year ended 30 June 2000.

**Required:**

Calculate the deferred tax expense for K Limited which would appear in the group financial statements under IAS 12 (revised) "Income Taxes" for the year ended 30 June 2000.

(10 marks)

**QUESTION FOUR**

Golden Treasures Retirement Benefit Scheme is a defined benefit scheme that has been operating for the last 30 years. The General Manager cannot understand why the accountants have been charging a constant pension cost in the financial statement different from the amounts of actual contributions made during the period. The fund accountant has explained to him that this is as a result of the difference between the funding and accounting for pension schemes in periods of pension scheme surpluses.

or deficits arising from variations in regular costs that are caused by factors such as experience adjustments and effects of changes in actuarial assumptions.

**Required:**

With reference to IAS 19 (Employee Benefits), revised, define the following terms:

- |  |           |
|--|-----------|
| (i). Experience adjustments.             | (4 marks) |
| (ii). Accrued benefit valuation methods. | (4 marks) |
| (iii). Current service cost              | (4 marks) |
| (iv). Vested employee benefits           | (3 marks) |

**QUESTION FIVE**

- (a). The actuarial valuation of Golden Treasures Retirement Benefit Scheme as at 31 December 2001 showed a deficiency of Sh.90 million. The actuary recommended that the company eliminated the deficiency by three lump sum payments of Sh.30 million each in addition to the standard contribution of Sh.10 million per annum. The contributions would continue at Sh.10 million per annum thereafter. The average remaining service life of employees in the scheme as at 31 December 2001 was 10 years. Determine the charge in the income statement and the figure to be disclosed in the scheme's balance sheet as a net pension liability or prepayment in each of the years 2002 to 2011.

(7 marks)

- (b). Suppose the actuarial valuation at 31 December 2001 of Golden Treasures Retirement Benefit Scheme showed a surplus of Sh.260 million. The actuary then recommended that the company eliminates this surplus by taking a contribution holiday for the first two years, and then pay yearly contributions of Sh.30 million for eight years. After the eight years, the standard contribution would be Sh.50 million per annum. The average remaining service life of employees in the scheme as at 31 December 2001 was 10 years.

**Required:**

Compute the figure to be charged in the income statement and the figure to be disclosed in the balance sheet of the scheme as a net pension liability or prepayment in each of the years 2002 to 2011.

(8 marks)

**QUESTION SIX**

- a) International Accounting Standards 1 encourages the preparers of accounts to present, outside the financial statements, a financial review by management. In the UK, this review is called "The Operating and the Financial Review " (OFR). In the US it is referred to as "Management's Discussion and Analysis of Financial Condition and Results of Operation "(MDA) what does IAS suggest should be contained in this report? (5 marks)
- b) IAS 1 goes on to suggest that enterprises should present additional statements such as environmental reports and value added statements. What are the reasons given to justify the presentation of these additional statements and when are they particularly used? (5 marks)
- c) IAS 32 "Financial Instruments: Disclosure and Presentation" states that the purpose of the disclosures required by this standard is to provide information that will enhance understanding of the significance of on-balance-sheet and off-balance-sheet financial instruments to an enterprise's financial position, performance and cashflow and assist in assessing the amounts, timing and certainty of future cashflows associated with those instruments. State and briefly describe three types of financial risks described in the standard, in relation to transactions in financial instruments. (5 marks)